

UNITED STATES BANKRUPTCY COURT

DISTRICT OF HAWAII

In re)	Case No. 03-00243
)	Chapter 7
JOHNNY CHRISTIE-PEQUIGNOT)	
and DAWN CHRISTIE-PEQUIGNOT,)	
)	
Debtors.)	
<hr style="width: 35%; margin-left: 0;"/>)	Adv. Proc. No. 03-90023
)	
ALEX FRADKOFF,)	
)	
Plaintiffs,)	
)	
vs.)	
)	
Bankruptcy Estate of)	
JOHNNY CHRISTIE-PEQUIGNOT)	
and DAWN CHRISTIE-PEQUIGNOT,)	
)	
Defendants.)	
<hr style="width: 35%; margin-left: 0;"/>)	

**MEMORANDUM DECISION REGARDING
MOTION FOR SUMMARY JUDGMENT**

Alex Fradkoff paid approximately \$247,000 toward the mortgages on the debtors' real property. The mortgages were not fully satisfied and the mortgages were never released. The debtors agreed to grant a new mortgage in favor of Mr. Fradkoff, but no such mortgage was ever recorded. Mr. Fradkoff

brought this adversary proceeding to determine the validity, priority, and extent of his claimed interest in the debtors' real property.

The Trustee filed an answer that asserts that the estate is the proper defendant and filed a counterclaim that seeks to avoid Mr. Fradkoff's interest pursuant to section 544. 11 U.S.C. § 544. The Trustee filed a motion for summary judgment on July 2, 2003, that was heard on August 12, 2003.¹ At the hearing, the court ordered the parties to file supplemental briefs.

The issues presented are: (1) whether the Trustee may avoid Mr. Fradkoff's unrecorded interest in the debtors' real property pursuant to section 544(a)(3), and (2) whether Mr. Fradkoff is entitled under the doctrine of equitable subrogation to the secured status created by the mortgages that the debtors paid down with Mr. Fradkoff's money. I conclude that the Trustee is a bona fide purchaser who holds the debtors' real property free of Mr. Fradkoff's interest and that equitable subrogation does not apply because the mortgages to which Mr. Fradkoff seeks subrogation were not fully satisfied.

¹ David Cain, Esq., appeared on behalf of the plaintiff Mr. Fradkoff; Ramon Ferrer, Esq., appeared on behalf of the debtors Johnny and Dawn Christie-Pequinot ("the debtors"); and Karina Terakura, Esq., appeared on behalf of the counter-claimant Trustee Sandra Loomis ("the Trustee").

Background

Tina Sohn holds a second mortgage on the debtors' real property located at 833 Kupulau Drive, Kihei, Hawaii. The debtors defaulted and Ms. Sohn commenced a foreclosure case. The debtors arranged for Mr. Fradkoff to wire an initial \$25,000 to Ms. Sohn in order to induce her to suspend the foreclosure proceedings.

Subsequently, on July 3, 2001, the debtors and Mr. Fradkoff (but not Ms. Sohn) executed a letter of agreement which provides that Mr. Fradkoff would loan the debtors \$225,000 and "in exchange for this loan Alex Fradkoff will hold a second mortgage." The letter of agreement further states:

It is further agreed, by both parties, that until this loan is paid back in full, Alex Fradkoff will be entitled to any and all ownership of the above property as is equal to the amount of this loan under this agreement as holder of this second mortgage and, until the above loan is repaid Alex Fradkoff will replace Tina Sohn as holder for the second mortgage.

Mr. Fradkoff wired funds, in incremental amounts totaling \$232,000, to the client trust account of the debtors' attorney between July 19, 2001, and August 21, 2002. The debtor's attorney paid an additional \$180,000 to Ms. Sohn and paid \$42,000 to Frank Xavier, who holds the first mortgage. The record does not clearly state what happened to the remaining \$10,000. About \$5,000 was

apparently used in connection with an unrelated arbitration. There is no question, however, that Ms. Sohn's mortgage was never fully satisfied.

The debtors and Mr. Fradkoff believed that the second mortgage held by Ms. Sohn had been satisfied and also believed that the letter of agreement between the debtors and Mr. Fradkoff had been recorded. They were wrong in both respects. Ms. Sohn's second mortgage was not satisfied in full; the remaining amount due on the second mortgage was \$3,754.84 plus attorneys' fees. Also, the letter of agreement between the debtors and Mr. Fradkoff was never recorded at the Bureau of Conveyances of the State of Hawaii. The debtors have stated that they would have informed anyone who wished to acquire an interest in the property that there were two mortgages – one held by Mr. Xavier and a second held by Mr. Fradkoff.

The debtors filed their Chapter 7 petition on January 28, 2003. The debtors filed their schedules on February 11, 2003. Schedule A, Real Property, identifies the subject property located at 833 Kupulau Drive in Kihei, Hawaii. Schedule D, Creditors Holding Secured Claims, identifies a mortgage of \$550,000 held by Mr. and Mrs. Xavier and a second mortgage of \$250,000 held by Mr. Fradkoff. The debtors did not list the second mortgage held by Ms. Sohn on their schedules.

The title report for the subject property reports a first mortgage held by Mr. and Mrs. Xavier for \$500,000 and a second mortgage held by Mr. and Mrs. Sohn for \$202,000, as well as other tax liens and judgments.

Discussion

A. Summary Judgment Is Appropriate

Summary judgment is appropriate when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The moving party has “the initial burden of identifying the portions of the materials on file that it believes show an absence of any genuine issue of material fact.” T.W. Elec. Serv., Inc. v. Pac. Elec. Contractors Ass'n, 809 F.2d 626, 630 (9th Cir.1987); see Celotex Corp. v. Catrett, 477 U.S. 317 (1986). If the moving party meets its burden, then the opposing party may not defeat a motion for summary judgment in the absence of any significant probative evidence tending to support its legal theory. Commodity Futures Trading Comm'n v. Savage, 611 F.2d 270, 282 (9th Cir.1979). In a motion for summary judgment, the court must view the facts in the light most favorable to the non-moving party. State Farm Fire & Casualty Co. v. Martin, 872 F.2d 319, 320 (9th Cir.1989).

The parties agree that Mr. Fradkoff’s letter of agreement was never recorded at the Bureau of Conveyances of the State of Hawaii and that the second

mortgage held by Ms. Sohn was not satisfied in full. There is no genuine issue as to any material fact and the matter can be decided as a matter of law.²

B. The Trustee's Rights As A Bona Fide Purchaser Pursuant To Section 544(a)(3)

The Trustee argues that she took the title to the subject property free and clear of all unrecorded liens, including Mr. Fradkoff's unrecorded mortgage, as a bona fide purchaser on the date of the petition. The Trustee relies on section 544(a)(3), which gives the trustee the status of a bona fide purchaser as of the commencement of the case.

Section 544(a), "the strong arm clause," gives a bankruptcy trustee the power to avoid certain transfers or liens against property of the bankruptcy estate. Section 544(a)(3) allows the trustee to avoid all obligations and transfers that would be avoidable by "a bona fide purchaser of real property . . . that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or not such a purchaser exists." Section 544(a) grants the bankruptcy

² Mr. Fradkoff contends that Ms. Sohn and counsel for the debtors conspired to give him the false impression that Ms. Sohn's mortgage had been paid off and that Mr. Fradkoff had become the second mortgagee. This allegation is implausible and, more importantly, it is immaterial. The trustee would still prevail even if there were such a conspiracy.

trustee this power “without regard to any knowledge of the trustee or of any creditor.”

A trustee as a hypothetical bona fide purchaser of real property is defined as:

A person who (1) at the instant the petition is filed, purchases from the debtor; (2) for value; (3) in good faith; (4) without actual knowledge of any defect or limitation in title; (5) every interest in real property the debtor could have purported to convey without the terms of the conveyancing instrument itself evidencing irregularity; (6) by an instrument that adheres to all formal requisites usually and regularly followed in the relevant jurisdiction (e.g. that the conveyance is in writing and acknowledged); and (7) who as of the moment of purchase, takes all unilateral steps under relevant nonbankruptcy law to perfect the conveyance (e.g. recording).

Saghi v. Walsh (In re Gurs), 27 B.R. 163, 165 (B.A.P. 9th Cir. 1983). The extent of the trustee’s rights as a bona fide purchaser of real property is measured by the substantive law of the jurisdiction governing the property in question. In re Wiseman, 5 F.3d 417, 419 (9th Cir. 1993).

Hawaii law provides that a mortgage must be recorded in the appropriate office (in this case, the bureau of conveyances.) Section 502-83 of the Hawaii Revised Statutes provides:

All deeds, leases for a term of more than one year, mortgages of any interest in real estate, or other conveyances of real estate within the State, shall be recorded in the bureau of conveyances. **Every such conveyance not so recorded is void as against any subsequent purchaser, lessee, or mortgagee, in good faith** and for a valuable

consideration, **not having actual notice** of the conveyance of the same real estate, or any portion thereof, or interest therein, whose conveyance is first duly recorded. [Emphasis added.]

In addition, under Hawaii case law, “where a party purchases or leases real estate in the possession of another not his vendor or lessor he is chargeable with knowledge of all the rights of the party in possession.” Yee Hop v. Young Sak Cho, 25 Haw. 494, 505 (1920).

Mr. Fradkoff argues that the Trustee had actual notice of his interest because the debtors claimed in their schedules that Mr. Fradkoff held a second mortgage. This argument fails because section 544(a) expressly provides that the trustee may exercise the rights and powers of a bona fide purchaser “without regard to any knowledge of the trustee or of any creditor.”³

Mr. Fradkoff also argues that the Trustee had constructive notice of his interest because the debtors testified (in their declaration in opposition to the Trustee’s motion) that if a prospective purchaser had asked them, they would have told the purchaser that Mr. Xavier held the first mortgage and Mr. Fradkoff held a

³ Briggs v. Kent (In re Prof'l Inv. Props. of Am.), 955 F.2d 623 (9th Cir. 1992), is distinguishable. In that case, the court held that, in an involuntary case, the trustee took the debtor’s real property subject to an equitable lien claimed by a petitioning creditor because the involuntary petition disclosed the claim. In this case, the voluntary petition itself did not mention Mr. Fradkoff’s claim. The schedules were not filed until several weeks later. See Huber v. Danning (In re Thomas), 147 B.R. 526, 531 n.8 (B.A.P. 9th Cir. 1992).

second mortgage. This argument also fails because, under Hawaii law, a bona fide purchaser has no duty to ask the titleholder about the status of any liens. The only situation in which a purchaser must inquire beyond the recorded documents is where someone other than the titleholder of record is in physical possession of the property. Yee Hop v. Young Sak Cho, 25 Haw. at 505. In such a case, the purchaser is charged with the knowledge of the possessor's rights. Mr. Fradkoff offered no authority for the proposition that a bona fide purchaser is obligated to ask the owner of record about unrecorded liens on the property.

C. Mr. Fradkoff Is Not Entitled To Equitable Subrogation

At the hearing, the court directed the parties to file supplemental memoranda on the question of whether the doctrine of subrogation allows Mr. Fradkoff to step into the shoes of Ms. Sohn and gain the benefit of the recorded mortgage of which she holds.

In general, subrogation is the substitution of one party in place of another with reference to a lawful claim, demand or right. Equitable subrogation⁴

⁴ The Trustee correctly argues that neither contractual or statutory subrogation is applicable to the facts of this case. Contractual subrogation does not apply because Ms. Sohn did not make a written assignment of her second mortgage to Mr. Fradkoff. Statutory subrogation provided for in 11 U.S.C. § 509 only refers to the claims of codebtors. Mr. Fradkoff does not contend that contractual or statutory subrogation applies.

“permits a party who satisfies another’s obligation to recover from the party ‘primarily liable’ for the extinguished obligations.” In re Hamada, 291 F.3d 645, 649 (9th Cir. 2002). Equitable subordination is a doctrine governed by state law. Id. at 651; Mort v. United States, 86 F.3d 890, 893 (9th Cir. 1996).

Hawaii law recognizes the principle of equitable subrogation.

“Where property of one person is used in discharging an obligation owed by another or a lien upon the property of another, under such circumstances that the other would be unjustly enriched by the retention of the benefit thus conferred, the former is entitled to be subrogated to the position of the obligee or lienholder.” Alamida v. Wilson, 495 P.2d 585, 590 (Haw. 1972) (citing Restatement (First) of Restitution §162 (1937)).

Equitable subrogation is available when five factors are satisfied:

“(1) payment was made by the subrogee to protect his own interest; (2) the subrogee has not acted as a volunteer; (3) the debt paid was one for which the subrogee was not primarily liable; (4) the entire debt has been paid; and (5) subrogation would not work any injustice to the rights of others.” In re Hamada, 291 F.3d at 655.⁵

⁵ The Hawaii courts have not expressly adopted the five factor test. I conclude that the Hawaii courts would do so if the question were squarely presented, because the five factors are found in the comments to the Restatement

The Trustee contends that Mr. Fradkoff does not satisfy any of the five factors because he did not make the payments to protect his own interests; he voluntarily made the payments; he was not liable for the debt; the debt was not paid in full; and equitable subrogation would work an injustice to the rights of lien holders and unsecured creditors.

Mr. Fradkoff asserts that he is entitled to equitable subrogation because he paid the debt for which another was primarily answerable when he made payments toward the mortgages of Ms. Sohn and Mr. Xavier with respect to the real property of the debtor. Mr. Fradkoff argues that he was not a volunteer because he entered into a letter of agreement with the debtors. Mr. Fradkoff asserts that Hawaii law does not require that the debt be paid in full and, thus, the remaining \$3,754.84 plus attorney's fees does not prevent subrogation. Mr. Fradkoff contends that it would be unconscionable and unjust to deprive him of a secured interest.

Mr. Fradkoff is not entitled to equitable subrogation because he did not fully discharge the debtors' obligation under the second mortgage held by

(First) of Restitution §162 (1937), and the Hawaii courts have cited and relied upon that section of the Restatement. See State Farm Fire and Casualty Company v. Pacific Rent-All, Inc., 978 P.2d 753, 769 (Haw. 1999); Alamida v. Wilson, 495 P.2d 585, 590 (Haw. 1972).

Ms. Sohn. “Where property of one person is used in partially discharging an obligation owed by another, and the balance of the obligation has not been discharged, the former is not entitled to be subrogated to the position of the obligee.” Restatement (First) of Restitution §162 comment c (1937).

In addition, applying equitable subrogation to benefit Mr. Fradkoff would be unjust to other creditors. One of the fundamental principles of bankruptcy law is that all creditors ought to be treated alike and ought to receive a pro rata share of the available assets unless there is a statutory basis for granting a particular creditor preferred treatment. A creditor holding a valid and perfected lien is entitled to such preferential treatment. Mr. Fradkoff, however, does not hold a valid or perfected lien. The granting of secured status to Mr. Fradkoff would come at the expense of other creditors and would be unjust to the other creditors.

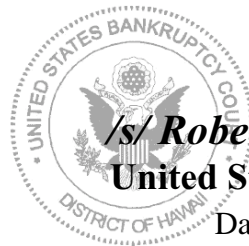
A person who partially pays the debts of another may be entitled to an equitable lien. “A person whose property is used in partially discharging a secured obligation is entitled to an equitable lien upon the security although the obligation has not been fully discharged, but his interest in the security is subordinate to that of the obligee.” Id. Mr. Fradkoff’s equitable lien, however, is subject to the Trustee’s avoidance powers pursuant to section 544(a)(3). An

unrecorded equitable lien does not survive the Trustee's avoidance powers pursuant to section 544(c)(3). The Trustee takes title to the real property free from all equitable liens. Nat'l Bank of Alaska, N.A. v. Erickson (In re Seaway Express Corp.), 912 F.2d 1125, 1128-29 (9th Cir. 1990); Wolf v. Mahrtdt (In re Chenich), 100 B.R. 512, 515 (B.A.P. 9th Cir. 1987).

D. Conclusion

As a bona fide purchaser, the Trustee is entitled to avoid Mr. Fradkoff's interest in the real property. Mr. Fradkoff is not entitled to equitable subrogation to the existing second mortgage because the debt was not fully paid. Thus, the Trustee is entitled to summary judgment.

An appropriate separate judgment will be entered.



/s/ Robert J. Faris

United States Bankruptcy Judge

Dated: October 24, 2003